2010

Citizens South: Innovative Use of TARP Funds Creates Value for Customers, Community, and the Bank

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Citizens South: Innovative Use of TARP Funds Creates Value for Customers, Community, and the Bank

I. INTRODUCTION

Nestled in the shadow of Charlotte, North Carolina, a banking hub for Wachovia¹ and Bank of America, is Citizens South Bank of Gastonia², North Carolina.³ Citizens South has total assets of less than $900 million and, like most community banks across the nation, is feeling the effects of the slow real estate market.⁴ Unlike many of its much larger counterparts, however, Citizens South is generating positive headlines.⁵ Through its participation in the Troubled Asset Relief Program (TARP), Citizens South has instituted a home lending program, the CPP Mortgage Program, designed to stimulate the local housing market.⁶ The CPP Mortgage Program makes credit available to local consumers at a low price while enabling Citizens South to turn nonperforming construction loans into home mortgages.⁷

Although the landscape of community banking is changing rapidly, Citizens South illustrates that innovative programs and products like the CPP Mortgage Program can address concerns arising from the recent financial crisis and act as a blueprint for successful community banking going forward.⁸

Part II of this Note will provide a brief overview of the community banking environment today.⁹ Part III will give a brief

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². The author’s father is currently a board member of Citizens South Bank.
⁴. See infra Part IV.
⁵. See infra p. 378 and notes 124-131.
⁶. See infra pp. 374-75 and notes 97-106.
⁷. See infra pp. 374-75 and notes 97-106.
⁸. See infra Part IV.
overview of TARP, an overview of the Capital Purchase Program (CPP), and examine the role the CPP has played in community banking during the current economic crisis. Part IV will explore Citizens South’s participation in TARP and its use of TARP funds to create a unique lending program.

II. COMMUNITY BANKING ENVIRONMENT TODAY

Some of the buzz-words surrounding the economic climate in the fall of 2008 were “systemic risk” and “too big to fail,” but community banks, which do not pose systemic risk and are not too big to fail, face different challenges and opportunities as a result of the financial crisis.

During 2009, the United States experienced a dramatic spike in the number of bank failures. More than 140 banks failed during the past year. By comparison, only twenty-six banks failed in 2008, and only twenty-seven banks failed from 2000 to 2007 combined. Many analysts expect that these numbers will increase further during the next several years as small banks deal with losses from residential and commercial real estate loans. The poor financial health of many community banks can be traced to two primary factors: (1) the condition of the local economy in

10. See infra pp. 366-73.
14. Id.
15. Id.
which the banks operate; and (2) the risks taken by individual banks in an effort to promote rapid growth.17

The case of Security Savings Bank in Henderson, Nevada, exemplifies the reasons that many banks across the United States have failed.18 In its report by the Inspector General, the FDIC outlined the causes of Security Savings Bank's failure:

[Bank management did not adequately control the risks associated with its business strategy that focused on (1) rapid asset growth, (2) significant concentrations in ADC [Acquisition, Development, and Construction] loans, (3) investments in lower-quality mortgage-backed securities, and (4) reliance on high-cost core deposits and volatile non-core funding. The deteriorating housing market in areas where Security held most of its loans led to significant loan and security losses that eroded the bank's capital and strained liquidity.19

As with many community banks across the country, Security Savings Bank was vulnerable to failure because it engaged in risky banking practices such as maintaining high concentrations of certain types of loans, investing in high-risk securities, and relying on high-cost deposits.20 When economic conditions worsened, banks like Security Savings Bank were significantly affected because they were too heavily invested in the quickly deteriorating housing market as well as unreliable sources of funding like "lower-quality mortgage-backed securities[,] . . . high-cost core deposits[,] and volatile non-core funding."21

17. See infra pp. 364-66 and notes 22-36.
19. Id. at 3.
20. Id. at 3.
21. Id. at 3.
A. Local Economic Conditions

Community banks were vulnerable not only because of risky banking practices, but also due to disproportionate participation in commercial real estate lending which tied the fortunes of small banks to the economies of the communities they serve. Although small to medium-sized banks hold only a small percentage of banking assets as a whole, they own about half of the banking industry's commercial real estate loans.

The downturn in the real estate markets has been the biggest local economic factor affecting the health of community banks. The real estate boom that characterized the early part of the decade ended dramatically, and many community banks have failed as a result. For example, numerous bank failures occurred in areas like California, Florida, and Georgia where, prior to the economic crisis, the real estate market was booming. In fact, bank failures in those states account for more than half of the bank failures in the United States in 2009.

In contrast, some banks, such as Iowa Trust and Savings Bank (Iowa Trust), have felt only minor effects of the economic downturn due to a strong local economy. Iowa Trust is located in an area largely reliant on farming where the high prices of corn have stimulated the local economy and actually improved Iowa Trust's business.
economies and the relative health of banks like Iowa Trust, illustrates the enormous impact that local economic health can have on community banks.

B. Efforts Aimed at Rapid Growth

Concentrated efforts to grow asset bases rapidly is another reason why many community banks have failed.\textsuperscript{30} For example, because banks in the slow-growing Midwest were unable to participate in the real estate boom occurring in other areas of the country, banks in Illinois turned to other investment opportunities in their search for growth.\textsuperscript{31} Many of these banks failed due to investments in risky securities that subsequently saw significant losses due to a rapid decline in investment value.\textsuperscript{32} Although other factors contributed to bank failures in Illinois, many community banks, under pressure from demands for rapid growth, abandoned their traditionally conservative banking practices in search of big returns on investments.\textsuperscript{33}

Though risky banking practices may not have foreshadowed the number of bank failures occurring today, their confluence with other elements of the financial crisis, such as the stagnant housing market, has had a disparate effect on community banks. Some community banks that employed conservative banking practices prior to the crisis have flourished because many consumers left larger financial institutions for smaller banks.\textsuperscript{34} Community banks have also benefitted from capital infusions from government-sponsored liquidity programs such as the CPP.\textsuperscript{35} By contrast, banks that sought high returns and rapid asset growth at

\textsuperscript{30} See MATERIAL LOSS, supra note 18, at 3; Barba, Why Illinois is Becoming Midwest's Failure Hub, supra note 12; Dash, Pathology of a Crisis, supra note 16 (noting relaxed lending standards).

\textsuperscript{31} See Barba, Why Illinois is Becoming Midwest's Failure Hub, supra note 12.

\textsuperscript{32} See id.

\textsuperscript{33} See id. Other major factors contributing to bank failures in Illinois include: 1) the slow real estate market that the suburbs outside of Chicago are experiencing; 2) more banks are headquartered in Illinois (652) than any other state. Id.

\textsuperscript{34} See Dash, Failures of Small Banks Grow, Straining F.D.I.C., supra note 16; Sisk, supra note 12.

\textsuperscript{35} See Dash, Failures of Small Banks Grow, Straining F.D.I.C., supra note 16; Sisk, supra note 12; infra pp. 8-16 and notes 42-92 (discussing the Capital Purchase Program).
the expense of security have floundered and often failed due to toxic assets on their books and the absence of government bail-outs.36

III. BACKGROUND ON TARP FUNDS AND THE CAPITAL PURCHASE PROGRAM

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (EESA) was passed in response to the deteriorating economic climate in the United States.37 EESA gave the Secretary of the Treasury the authority to establish the TARP under the newly created Office of Financial Stability.38 The purpose of TARP was to “purchase, and to make and fund commitments to purchase, troubled assets from any financial institution, on such terms and conditions as are determined by the Secretary.”39 The term “troubled assets” was defined to include “any ... financial instrument that the Secretary ... determines the purchase of which is necessary to promote financial market stability.”40 This broad language eventually formed the basis for the creation of the CPP, a program within TARP that provided banks with inexpensive capital infusions through the Treasury's purchase of banks' preferred stock.41


A. The Capital Purchase Program Generally

The CPP, as it was first announced in October of 2008, was created to inject capital into the country’s largest financial institutions.\(^{42}\) To accomplish this, the Treasury would purchase shares of preferred stock in participating institutions.\(^{43}\) The Treasury initially set aside $250 billion for this program, and at the time of its announcement, nine large financial institutions had committed to the program, taking up roughly half of the program’s initial budget.\(^{44}\) The program was used extensively over the next eight months; by mid-June 2009, the Treasury purchased almost $200 billion worth of preferred stock in financial institutions of all sizes.\(^{45}\)

To be approved for receipt of CPP funds, qualified financial institutions were required to submit an application to their primary regulator.\(^{46}\) Each institution approved to receive funds was eligible to issue preferred stock equal to between one and three percent of that institution’s risk-weighted assets.\(^{47}\) Participating institutions must pay dividends on the preferred stock in the amount of five percent per year for the first five years that the institution holds the preferred stock and nine percent per year thereafter.\(^{48}\) The availability of quick capital infusions at what is essentially a very low interest rate made this program very

\(^{42}\) Id.
\(^{43}\) Id.
\(^{44}\) Id.


\(^{46}\) TARP Capital Purchase Program, Senior Preferred Stock and Warrants: Summary of Senior Preferred Terms, http://financialstability.gov/docs/PP/termshet.pdf (last visited Jan. 7, 2010) [hereinafter Summary of Senior Preferred]. Qualified financial institutions include: (1) U.S. banks and savings associations; and (2) U.S. Bank Holding Companies and Savings and Loan Companies so long as the Savings and Loan Company “engages solely or predominately in activities that are permitted for financial holding companies[,]” Id. at 1.

\(^{47}\) Summary of Senior Preferred, supra note 46. There is also a limit of $25 billion although this is irrelevant to community banks. See id.

\(^{48}\) Summary of Senior Preferred, supra note 46, at 2.
attractive to community bankers.\textsuperscript{49} In fact, many bankers took money largely because of the low cost of the capital compared to the alternatives.\textsuperscript{50}

In addition to required dividends, institutions participating in the CPP must issue warrants to the Treasury to buy their common stock.\textsuperscript{51} For public companies, the amount of the warrants is equal to fifteen percent of the Treasury's original CPP investment divided by the exercise price.\textsuperscript{52} The exercise price is defined as the average stock price of the company for the twenty day period prior to initial approval to participate in the CPP.\textsuperscript{53}

The original application deadline for banks to apply for CPP funds was in November 2008; however, the application period for CPP funds was extended until November 21, 2009 for small banks.\textsuperscript{54} Only the smallest community banks, those with $500 million in assets or less, were eligible to apply.\textsuperscript{55} This second phase of the CPP also offered participants more favorable terms than the original program including the right to issue preferred stock up to five percent of risk-weighted assets compared to a cap of three percent under the original program.\textsuperscript{56} Additionally, participants were only required to issue warrants to accompany the preferred stock up to three percent of the bank's risk-weighted assets instead of issuing warrants to match all of the preferred stock issued through the program.\textsuperscript{57} Participants in the first round of the CPP

\textsuperscript{49} See, e.g., Interview with Kim Price, CEO, Citizens South Banking Corp., in Gastonia, N.C. (Sept. 21, 2009) [hereinafter Interview with Kim Price] (noting the low cost of capital available through CPP).

\textsuperscript{50} See, e.g., id. (estimating that alternatives to CPP would have cost at least eleven to fourteen percent).

\textsuperscript{51} \textsc{Summary of Senior Preferred, supra} note 46.


\textsuperscript{53} Id.

\textsuperscript{54} See \textsc{U.S. Dep't of the Treasury, Frequently Asked Questions Regarding the Capital Purchase Program (CPP) for Small Banks}, available at http://financialstability.gov/docs/CPP/FAQonCPPforsmallbanks.pdf (last visited Jan. 8, 2010).

\textsuperscript{55} See id.

\textsuperscript{56} See id.

\textsuperscript{57} See id.
that qualified for the second round could re-apply to receive the additional permitted funds.\textsuperscript{58}

\textbf{B. The Capital Purchase Program and Community Banks}

Initially, all of the institutions participating in the CPP were large banks, but many community banks have since decided to participate.\textsuperscript{59} Non-economic costs associated with participation, however, dissuaded many community banks from seeking funds through the program and forced those that did participate to adopt specialized programs to address those costs.\textsuperscript{60}

The Treasury stated that the purpose of the CPP was to “inject much-needed capital into the system” by “increasing the capital base of an array of healthy, viable institutions, enabling them to lend to consumers and businesses.”\textsuperscript{61} These goals indicate that the focus of the CPP was on consumers rather than on banks. Thus, the CPP was not intended to be a “bailout” for banks but rather entrusted healthy banks with the ability to facilitate the flow of credit to consumers.\textsuperscript{62} Necessarily, regulation of the CPP sought to protect consumers, but banks that participated in the CCP were forced to balance the interests of the bank with those of the consumers because of heavy regulation of CPP funds, requirements for participation in the CPP, and the public stigma associated with TARP.\textsuperscript{63}

\begin{itemize}
\item \textsuperscript{58} See id.
\item \textsuperscript{59} See OFFICE OF FIN. STABILITY, TROUBLED ASSET RELIEF PROGRAM TRANSACTIONS REPORT: CAPITAL PURCHASE PROGRAM, Jan. 4, 2010, available at http://financialstability.gov/docs/transaction-reports/1-610%20Transactions%20Report%20as%20of%201-4-10.pdf.
\item \textsuperscript{61} U.S. Dep't of the Treasury, Factsheet on Capital Purchase Program, http://financialstability.gov/roadtostability/CPPfactsheet.htm (last visited on Jan. 7, 2010) [hereinafter CPP Factsheet].
\item \textsuperscript{62} Id.
\item \textsuperscript{63} See Murray, et al., supra note 60; Solomon, supra note 60.
\end{itemize}
1. Regulation

In addition to paying dividends and issuing warrants to buy common stock, each participant in the CPP must comply with several conditions imposed by the Treasury.⁶⁴ Among these conditions are restrictions on dividends, share repurchases, and executive compensation.⁶⁵ Moreover, a standard term in CPP contracts provides that the Treasury may "unilaterally amend any provision...to the extent required to comply with any changes after the Signing Date in applicable federal statutes."⁶⁶ This open-ended provision leaves participants at the mercy of lawmakers and made many bankers wary of participation in the CPP because of the possibility that additional conditions would attach to their TARP investment.⁶⁷

The Treasury has also instituted stronger methods of monitoring the uses of the CPP funds at participating banks.⁶⁸ Early Treasury press releases and descriptions of the program

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⁶⁷ See Murray, et al., supra note 60; Solomon, supra note 60.

seemed to imply that CPP funds should be used to promote lending programs, but there was very little formal regulation of the use of CPP money.69 As a result, many participants did not limit their use of funds to programs directed toward increasing lending opportunities.70 A survey taken of program participants in November 2008 showed that while most participants planned to use funds in lending programs, eleven percent of participants planned to use funds to shore up their capital position, twenty-eight percent planned to use funds to defend against future losses, and eight percent planned to use funds to acquire other banks.71 Since that time efforts to monitor participants have grown.72 Early monitoring focused on the largest banks, but has expanded to include quarterly reports from all participants in the CPP.73 A more recent proposal would increase monitoring efforts by requiring each participant to submit monthly reports on their uses of CPP funds.74 These reporting requirements place significant administrative burdens on community banks with limited resources.

2. Exclusive Participation

The requirement that a financial institution be deemed “healthy” in order to participate in the CPP has created concern
Many in the industry believe that the CPP has the effect of widening the divide between healthy and struggling community banks. Small, struggling banks claim that they have been left to fail while the government has saved banks deemed "too big to fail" through other TARP programs and provided inexpensive capital to healthy community banks through the CPP. In fact, this belief has led some bankers to push for a new TARP program intended to help struggling community banks, but such a program is very unlikely to occur.

3. Public Stigma

A primary concern that many community banks have about participation in the CPP is the public stigma that attaches to institutions that take government funds. Although the Treasury has emphasized that the CPP is not a "bailout" and is only available to healthy banks, many bankers believe that the general public takes a different view. For many bankers, concerns over perceived weakness play a big role in deciding whether or not to participate in the CPP. In fact, bankers who have decided to participate in the program have often launched marketing campaigns reassuring the communities in which they operate that they are healthy and ready to lend to qualified consumers. For example, shortly after receiving TARP funds, Intermountain Community Bancorp in Sandpoint, Idaho launched a "Powered by

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75. See Barba, Making a Case to Give Tarp to Strugglers, supra note 36; Ludwig, supra note 36.
76. See Barba, Making a Case to Give Tarp to Strugglers, supra note 36; Ludwig, supra note 36.
77. See Barba, Making a Case to Give Tarp to Strugglers, supra note 36; Ludwig, supra note 36.
78. See Barba, Making a Case to Give Tarp to Strugglers, supra note 35; Ludwig, supra note 36.
80. CPP Factsheet, supra note 61.
81. See, e.g. Fajt, et al., supra note 79; Interview with Kim Price, supra note 49.
83. See Steve Garmhausen, The Big Outreach: Credit Crisis Spurs Grassroots Revival, AM. BANKER, April 28, 2009, available at 2009 WLNR 794522; Sidel, supra note 82.
Community" initiative to make consumers in the communities it serves aware that the bank was ready to lend.\textsuperscript{84} Intermountain worked with community leaders and volunteers to create various lending opportunities primarily aimed at local businesses and organizations.\textsuperscript{85} By involving the local community in efforts to promote lending, Intermountain was able to instill public confidence in the bank's health.\textsuperscript{86} Many bankers that have proactively addressed the negative public opinion associated with TARP have reported positive feedback and support from their communities.\textsuperscript{87}

By contrast, some industry commentators believe that banks that did not take CPP funds are seen as weak.\textsuperscript{88} They argue that the CPP provides an easy way for the public to distinguish the "winners" from the "losers" because the Treasury only allows banks deemed healthy to participate.\textsuperscript{89} Because disbursement of CPP funds is conditioned on a bank's financial health, failure to participate may reflect negatively on a bank's financial position, but any such assumption is untrue.\textsuperscript{90} Some banks chose not to participate because of prohibitive costs and so did not submit an application for review.\textsuperscript{91} Many other factors go into a bank's decision to participate in the CPP, and a bank's decision not to participate should not be interpreted as an indictment on the health of the bank.\textsuperscript{92}

\begin{itemize}
\item \textsuperscript{84} Garmhausen, \textit{supra} note 83.
\item \textsuperscript{85} Id.
\item \textsuperscript{86} Id.
\item \textsuperscript{87} See id.; Sidel, \textit{supra} note 82.
\item \textsuperscript{88} Robert Barba, \textit{The Real 'Scarlet Letter' Was Not Receiving Tarp}, \textit{AM. BANKER}, Sept. 18, 2009 available at 2009 WLNR 18298027.
\item \textsuperscript{89} Id.
\item \textsuperscript{90} See CPP Factsheet, \textit{supra} note 61; \textit{SUMMARY OF SENIOR PREFERRED}, \textit{supra} note 46; Solomon, \textit{supra} note 60.
\end{itemize}
IV. THE CITIZENS SOUTH PROGRAM

A. Background on Citizens South Bank

Citizens South Bank is a small community bank headquartered in Gastonia, North Carolina.93 The bank operates fifteen local branches and, as of June 30, 2009, had approximately $836 million of assets.94 Citizens South’s participation in the CPP is a particularly compelling example of the benefits of participation because it realizes the Treasury’s purpose in offering the program to smaller banks by increasing available lending to local consumers and businesses.95 Specifically, Citizens South Bank implemented a program geared towards stimulating the local housing market.96

B. The Program

Citizens South decided to participate in the CPP, despite being well-capitalized, because of the low cost of capital made available through the program.97 Because healthy banks were encouraged by the Treasury to participate, Kim Price, CEO of Citizens South, initially believed that participation in the CPP would bolster public opinion of the bank.98 Accordingly, in February 2009, Citizens South became a participant in the CPP by selling $20.5 million in senior preferred stock to the U.S. Treasury.99

93. Citizens South is a federally chartered savings bank and is owned by Citizens South Banking Corporation, a publicly traded organization that is incorporated in Delaware but has its headquarters in North Carolina. Office of Thrift Supervision Institutional Profile: Citizens South Bank, http://www.ots.treas.gov/?p=Institution Search&iid=02449 (last visited Jan. 8, 2010).

94. Id.

95. See CPP Factsheet, supra note 61; SUMMARY OF SENIOR PREFERRED, supra note 46.

96. See infra pp. 374-75 and notes 97-106.

97. Kim Price, CEO of Citizens South, notes that at the time the bank decided to participate the cheapest form of capital that would have been available to his bank would have cost between 11% and 14% interest annually, while the funds from the CPP would not cost the bank half of that. Interview with Kim Price, supra note 49.

98. Price said that the overall impression was that the bank would be helping the country by taking this money and increasing its lending. Interview with Kim Price, supra note 49.

99. See Capital Purchase Contract: Citizens South Banking Corporation, Dec. 12,
Upon receiving the CPP funds, Citizens South instituted a lending program, the CPP Mortgage Program, aimed at stimulating the local housing market. The structure of the lending program reflected Price's observations of the local economy, the sources of the economic crisis, and a desire to keep in line with the initial goals of the CPP. Builders and developers who were customers of Citizens South could waive closing costs in exchange for Citizens South's provision of low-cost home loans to potential homebuyers. The goal of the CPP Mortgage Program was to stimulate demand for local housing by offering favorable terms to potential homebuyers. This in turn would generate business for local real estate developers, builders, and subcontractors that were customers of Citizens South by providing them with the funds needed to service or repay outstanding loans with the bank. Finally, the repayment of builder and developer loans would benefit Citizens South because it would allow the bank to reduce the risk of its loan portfolio by replacing commercial loans with safer home loans.

C. The Results

Because local housing market trends have played such a large role in the health of community banks, one way to examine

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101. See Interview with Kim Price, supra note 49.
102. The program is only available through builders and developers that do business with Citizens South and have agreed to participate in the program. Currently about fifty builders in the area participate in the program. See id.
103. Under the initial terms of the program closing costs were paid for by the builders and the bank offered homebuyers a 30-year mortgage with an introductory interest rate of 3.5% which escalates to 5.5% after the first two years. At the time the market rate was 5.5%. Since the introduction of the program market interest rates have decreased and Citizens South has adjusted the rates of the mortgage to 2.875% and 4.875% respectively to reflect the change in market rates. Citizens South Website, http://www.citizenssouth.com, (last visited Jan. 9, 2010).
104. Interview with Kim Price, supra note 49.
105. Id.
106. Id.
the effectiveness of Citizens South’s CPP Mortgage Program is to compare its financial performance with banks operating in the same locality.\textsuperscript{107} Two banks that are appropriate for this comparison are First National Bank of Shelby, North Carolina (First National) and CommunityOne Bank of Asheboro, North Carolina (CommunityOne).\textsuperscript{108}

1. Set Up for Success

Citizens South was well-positioned to successfully deploy the CPP funds. The local economy in which it operates fared better in the economic crisis than other areas of the country.\textsuperscript{109} Furthermore, the bank’s loan-loss reserves indicate that it exercised conservative lending practices.\textsuperscript{110} From the second quarter of 2008 to the second quarter of 2009, Citizens South’s allowance for loan losses amounted to an average of 1.26% of total loans compared to 1.39% for First National and 1.92% for CommunityOne.\textsuperscript{111} Citizen South’s low ratio, when compared to similar banks in the region, supports Mr. Price’s assertion that Citizens South did not get caught up in the real estate boom.\textsuperscript{112} Furthermore, Citizens South reported a 28.5% rise in allowance for loan losses over the past year.\textsuperscript{113} While some increase in allowance for loan losses is expected given the economic downturn, by comparison, First National’s allowance for loan losses rose by 44% over that time and CommunityOne’s allowance

\textsuperscript{107} See infra pp. 376-78 and notes 109-131.

\textsuperscript{108} As of June 30, 2009 First National had total assets of approximately $1.04 billion and CommunityOne had total assets of approximately $2.2 billion. See FDIC Institution Directory, http://www2.fdic.gov/idasp/index.asp (last visited Jan. 8, 2010) (follow “Find Institutions” hyperlink, then search FDIC Certificate # 4910 and FDIC Certificate # 4879 respectively).

\textsuperscript{109} See supra p. 364 and notes 22-27.

\textsuperscript{110} See FDIC Institution Directory, supra note 108; Dash, Failures of Small Banks Grow, Straining F.D.I.C. of Small Banks Grow, supra note 16; Hill, supra note 22.


\textsuperscript{112} Interview with Kim Price, supra note 49; see also Pearlstein, supra note 65.

\textsuperscript{113} FDIC Institution Directory, supra note 111.
rose by 95.5%. In general, loans made by Citizens South appear to have been less risky than those made by its competitors.

2. Success of the Program

During the first seven months of its existence, the CPP Mortgage Program generated about twenty additional loans that would not have been made otherwise - a significant increase for a bank that normally makes about seventy-five residential mortgage loans per month. These additional loans brought in extra business for the bank, and have enabled the bank to turn $6 million of non-performing assets into performing assets by replacing commercial loans to struggling builders and developers with residential loans for homebuyers. However, the use of the program has been lower than Price initially expected. He believes the slow start is largely due to the continued slowdown in the local housing market but unquestioningly believes that the program has been a success.

During the first two quarters of 2009, while the program has been in effect, Citizens South’s total loans have risen only about .5% compared to 1.7% at First National and 2.2% at CommunityOne. Since Citizens South is offering the program only through builders who already have loans outstanding at Citizens South, the success of the program depends on the bank’s ability to move construction and commercial loans to the more stable home mortgage loans. Thus, the increase in loans is better examined by measuring the relative values of construction and home mortgage loans over this time. Since the program was implemented, Citizens South’s construction and land development loans decreased by nearly twenty-two percent. Construction and

114. Id.
115. Interview with Kim Price, supra note 49.
116. Id.
117. Id.
118. See id.
119. FDIC Institution Directory, supra note 111.
120. Interview with Kim Price, supra note 49.
land development loans at CommunityOne decreased by about 2.5 percent and at First National increased by 1.75 percent. These numbers imply that the program is doing what it was designed to do: decreasing loans held by developers and putting them into the hands of homeowners.

The success of the program has also generated goodwill as a result of national media coverage. Price reports that in the first sixty days after the initial media blitz, Citizens South took in about $50 million in new deposits. This goodwill, however, has not had a significant long-term impact on the bank when compared to other local community banks. While Citizens South did have a jump in deposits in the first quarter of 2009, the quarter in which the program was announced, new deposits have trailed off since that time. Citizens South has seen a growth of about 6% in total deposits. Over the same period, deposit growth at First National was 8.8% and nearly 8.9% at Community. While Citizens South’s rapid increase in deposit growth rate can be partly attributed to the announcement of the CPP Mortgage Program and the subsequent goodwill it produced, it appears that other community banks have also experienced an increase in deposits. Increased deposits may indicate that consumers are leaving larger banks for local banks that they perceive as more trustworthy rather than illustrate the particularized impact of Citizens South’s program.

122. Id.
123. Interview with Kim Price, supra note 49.
124. Id.; see O’Daniel, supra note 100; Pearlstein, supra note 65.
125. Interview with Kim Price, supra note 49.
126. FDIC Institution Directory, supra note 111.
127. FDIC Institution Directory, supra note 121
128. Id.
129. FDIC Institution Directory, supra note 111. Citizens South’s total deposits actually shrunk by .57% during the three quarters prior to the announcement of the program. During that same time deposits grew at First National by 1.43% and at Community by 1.97%. Id.
130. Id.
131. See Sisk, supra note 12.
3. Direction for the Future

Despite the relative success of the program, in late October 2009, Citizens South announced that it would repay the funds received from the CPP with the proceeds from a $30 million stock offering.\(^{132}\) Citizens South cited "negative public sentiment and congressional intervention" as its reason for wanting to pay back the money.\(^{133}\) As of that time, approximately $10 million of the $20.5 million in CPP funds had been used for the CPP Mortgage Program; however, Citizens South said that it would "honor [its] commitment" and continue offering the program until the $20.5 million was used.\(^{134}\) Citizens South withdrew its stock offering about a week after its announcement, finding that the "capital markets [had] softened" after a disappointing third quarter for the banking industry.\(^{135}\) Thus, Citizens South will likely continue to participate in the CPP for the foreseeable future but will return to the capital markets when conditions improve.

Although Citizens South's desire to repay the CPP funds indicates that it no longer wants to remain a participant in the CPP, it does not mean that its CPP Mortgage Program has been a failure. The CPP was intended to be a short term program that provided a quick injection of capital to open lines of credit to consumers and businesses.\(^{136}\) This is evidenced by the stated goals of the CPP as well as significant increases in dividend rates required by preferred stock issued through the CPP.\(^{137}\) Citizens South's desire to repay its obligations under the CPP indicates little more than an effort to remove itself from the costs of the


\(^{133}\) Id.

\(^{134}\) Id.


\(^{136}\) CPP Factsheet, *supra* note 61; SUMMARY OF SENIOR PREFERRED, *supra* note 46.

\(^{137}\) For a discussion of the costs of the CPP, both economic and non-economic, see *supra* Part III, and notes 37-92.
program while its commitment to continue the CPP Mortgage Program is evidence of that program’s success.138

V. CONCLUSION

Citizens South illustrates how innovative products and programs, like the CPP Mortgage Program, can harmonize the goals of the CPP with the interests of participating banks. Through its CPP Mortgage Program, Citizens South accomplished the goals of the CPP by making low-cost credit available to consumers.139 Moreover, it created value for the bank by replacing underperforming construction and development loans with less risky home mortgage loans.140 Citizens South’s program was a success for all involved: the builders and developers who were able to generate new business and pay down their loans, potential homeowners who were able to take advantage of attractive interest rates and no closing costs, and for the bank which was able to reduce risk in its loan portfolio as well as create new loans.141 When faced with a decision about how to increase lending with the CPP funds, Citizens South reached out to its own customer base to create a program that stimulated the housing market, effectively utilizing the most significant competitive advantage of community banks: their relationship with the communities they serve.142

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138. For a discussion of the costs of the CPP, both economic and non-economic, see supra Part III, and notes 37-92.
139. See supra Part IV.
140. See supra Part IV.
141. See supra Part IV.
142. See supra Part IV.